

ST 02-16

Tax Type: Sales Tax

Issue: Gross Receipts

Unreported/Underreported Receipts (Fraud Application)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

THE DEPARTMENT OF REVENUE)	Docket No.	01-ST-0000
OF THE STATE OF ILLINOIS)	IBT No.	0000-0000
v.)	NTL No.	00-0000000000000000
ABC CORP.,,)	John E. White,	
Taxpayer.)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Virginia Prihoda appeared for ABC Corp.; Mark Muchin, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose after ABC Corp. ("ABC" or "taxpayer") protested a Notice of Tax Liability ("NTL") the Illinois Department of Revenue ("Department") issued to it. The NTL assessed retailers' occupation tax, penalties and interest as measured by taxable gross receipts ABC was determined to have received regarding its retail sales of tangible personal property during the months beginning January 1, 1997 through and including April 30, 1999.

Prior to hearing, the parties agreed that the only issue to be resolved was the propriety of a fraud penalty the Department assessed as part of the NTL. I have considered the evidence adduced at hearing, and I am including in this recommendation specific findings of fact and conclusions of law. I recommend that the NTL be finalized as issued.

Findings of Fact:

1. ABC is a corporation that is engaged in the business of making sales of tangible personal property, to wit: food, beer and liquor, at retail. Department Exhibit (“Ex.”) 1, p. 2 (a copy of the Department’s correction of taxpayer’s returns); Hearing Transcript (“Tr.”), pp. 16-17 (testimony of Charles Lynch (“Lynch”)), special agent in the Department’s Bureau of Criminal Investigation).
2. ABC’s conducts business in Chicago, Illinois. Department Ex. 1.
3. Jane Doe (“Doe”) is ABC’s president, and she also worked at the business on a day-to-day basis. Tr. pp. 17 (Lynch), 74-75, 81 (Doe). The store is Doe’, and her family’s, sole source of income. Tr. pp. 17 (Lynch), 73 (Doe).
4. Doe purchased ABC, and began operating the retail business, on December 31, 1986. Tr. pp. 81-82 (Doe). Doe and her husband were ABC’s only employees. Tr. p. 20 (Lynch).
5. Doe regularly purchased the goods ABC sold at retail, and she knew who ABC’s vendors were. Tr. pp. 18-19 (Lynch), 83 (Doe).
6. ABC had a business checking account, and Doe did the banking for ABC. Tr. pp. 18-19 (Lynch), 83 (Doe).
7. ABC regularly restocked the goods it sold at retail. Tr. p. 18 (Lynch).
8. Doe ran a cash register total tape at least once a day. Tr. pp. 76-77 (Doe).
9. On days when Doe’ husband worked at the store, Doe occasionally ran cash register total tapes to see whether she or her husband made more sales. Tr. p. 76 (Doe).
10. Doe hired a Joe Blow (“Blow”) to perform accounting services for ABC. Tr. pp. 68, 80 (Doe). At the time of the audit, Blow had been working as ABC’s accountant for about ten years. Tr. pp. 68, 80 (Doe).
11. Blow prepared ABC’s monthly Illinois sales and use tax returns. Tr. p. 69 (Doe).
12. Blow prepared ABC’s monthly returns using purchase invoices and cash register tapes Doe kept for that month, and then gave to Blow. Tr. pp. 69, 72 (Doe).

13. Once Blow prepared ABC's monthly returns, he gave them to Doe, and she signed them. Tr. p. 70 (Doe).
14. ABC operated one store. Tr. p. 17 (Lynch). It made no wholesale sales of goods to others, and it regularly replaced goods sold each month. Tr. pp. 18, 21 (Lynch).
15. The Department audited ABC's business for the period beginning January 1, 1997 through and including June 30, 1999. Department Exs. 1, 3.
16. The audit was initiated as result of a special group that examined cash businesses like liquor stores and bars. Tr. pp. 15-16 (Lynch), 52 (testimony of Sal Marchetti ("Marchetti"), a Department auditor).
17. As part of his audit, Lynch subpoenaed ABC's suppliers of beer, liquor, wine and cigarettes for records regarding ABC's purchases of such goods for resale. Tr. p. 21 (Lynch).
18. Lynch also interviewed Doe and Blow as part of his audit. Tr. pp. 17-23, 27-32 (Lynch), 67-68 (Doe).
19. During his interview with Doe, she told Lynch, *inter alia*, that ABC's daily receipts were approximately 400 to 700 dollars a day. Tr. p. 18 (Lynch).
20. Lynch sought to review ABC's books and records, and Blow produced some of ABC's records. Tr. p. 29 (Lynch).
21. All of ABC's cash register tapes were not produced to Lynch. Tr. p. 29 (Lynch).
22. After obtaining information from ABC's vendors, Lynch prepared a schedule comparing ABC's total purchases from the vendors canvassed during each month in the audit period, with the amount of total receipts ABC reported as having received from selling general merchandise on its monthly sales and use tax returns. Department Ex. 3 (Lynch's schedule); Tr. pp. 21, 23 (Lynch).
23. Lynch's schedule included the following information:

Period	Purchases per Supplier Records	General Merchandise Receipts per Returns Filed	Unreported General Merchandise Receipts	Additional Tax Due / Criminal Financial Harm
1/97	11,125.15	3,092	8,033.15	702.90
2/97	10,841.21	3,169	7,672.21	671.31
3/97	10,590.38	2,680	7,910.38	692.15
4/97	10,872.59	3,224	7,648.59	669.25
5/97	13,215.85	2,198	11,017.85	964.06
6/97	13,346.56	2,230	11,116.56	972.69
7/97	14,097.40	2,740	11,357.40	993.77
8/97	17,406.05	4,290	13,116.05	1,147.65
9/97	12,962.20	3,390	9,572.20	837.56
10/97	15,360.49	2,983	12,377.49	1,083.03
11/97	11,862.04	3,077	8,785.04	768.69
12/97	13,862.81	3,210	10,652.81	932.12
1/98	10,495.79	4,381	6,114.79	535.04
2/98	12,623.36	3,011	9,612.36	841.08
3/98	13,834.83	3,120	10,714.83	937.54
4/98	13,512.47	3,196	10,316.47	902.69
5/98	16,976.92	3,317	13,659.92	1,195.24
6/98	15,669.42	3,219	12,450.42	1,089.41
7/98	19,069.35	3,450	15,619.35	1,366.69
8/98	17,635.30	3,116	14,519.30	1,270.43
9/98	17,261.19	3,118	14,143.19	1,237.52
10/98	19,502.54	3,480	16,022.54	1,401.97
11/98	16,057.35	4,103	11,954.35	1,046.00
12/98	27,635.86	3,814	23,821.86	2,084.41
1/99	18,937.27	3,315	15,622.27	1,366.94
2/99	17,672.90	3,136	14,536.90	1,271.97
3/99	19,979.05	3,591	16,388.05	1,433.95
4/99	20,813.30	4,291	16,522.30	1,445.70
[Totals*	433,219.63	91,941	341,278.63	29,861.76]

Department Ex. 3. (* the totals included on this page do not appear in Lynch's schedule, and were calculated by this writer).

24. Lynch's schedule shows that, during the time when ABC purchased over \$430,000 worth of goods for resale to others, for an average of about \$15,472 worth of goods each month ($433,220/28 \approx 15,472.14$), it reported to the Department that it had realized a little less than \$92,000, for an average of about

- \$3,284 each month ($91,941/28 \approx 3,283.60$), in gross receipts from selling goods at retail. Department Ex. 3.
25. Marchetti used Lynch's schedule when concluding the Department's audit of ABC for the period at issue. Tr. pp. 54, 56-57 (Marchetti).
 26. Marchetti added a 25% mark-up of ABC's wholesale cost of goods purchased for resale, and used that sum as ABC's taxable gross receipts for the audit period. Tr. p. 54 (Marchetti). He calculated tax on that amount, and then gave credit to ABC for the tax it paid with its filed returns. Tr. p. 54 (Marchetti).
 27. Marchetti also assessed late filing, late payment and fraud penalties as part of his audit. Department Ex. 1; Tr. p. 55 (Marchetti). Marchetti based the fraud penalty on the gross underreporting of taxable gross receipts disclosed by the audit, on the lack of complete books and records, and on the fact that the audit resulted in a criminal prosecution. Tr. pp. 58-61 (Marchetti).
 28. As a result of the Department's audit, Doe pled guilty to the misdemeanor offense of Attempt in that, while intending to commit the offense of Filing a Fraudulent Sale Tax Return, 35 **ILCS** 120/13, she performed an act that constituted a substantial step toward the commission of that offense. Department Ex. 4, pp. 1 (Department report prepared by Lynch and dated 2/8/01), 2 (Sentence of Probation Order signed by Judge Colleen McSweeney Moore and Doe, dated 2/8/01); Tr. p. 73 (Doe); *see also* 720 **ILCS** 5/8-4 (criminal offense of Attempt); Tr. pp. 34 (Lynch), 58 (Marchetti).

Conclusions of Law:

The Department introduced a copy of the corrections of ABC's returns into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the ROTA, that correction of returns constitutes prima facie proof of the correctness of the amount of tax due. 35 ILCS 120/4. The Department's prima facie case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

Section 3-6 of the Uniform Penalty and Interest Act provides, in part:

Penalty for fraud.

(a) If any return or amended return is filed with intent to defraud, in addition to any penalty imposed under Section 3-3 of this Act, a penalty shall be imposed in an amount equal to 50% of any resulting deficiency.

* * * *

35 ILCS 735/3-6 (1994). The standard for determining whether a fraud penalty is appropriate is "... that of clear and convincing evidence." Puleo v. Department of Revenue, 117 Ill. App. 3d 260, 268, 453 N.E.2d 48, 53 (4th Dist. 1983). Proof of fraud requires proof of the element of intent, and intent may be shown by circumstantial

evidence. Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213, 454 N.E.2d 799, 802 (3d Dist. 1983).

Here, taxpayer argues that the Department improperly imposed a fraud penalty. Specifically, it asserts that the evidence does not support a conclusion that Doe had the requisite intent to form the basis of a civil fraud penalty, since Doe reasonably relied on her accountant's services when he prepared ABC's monthly sales and use tax returns. Tr. p. 85 (closing argument). ABC further contends that Doe did not understand how ABC's returns were prepared (Tr. p. 86), and that Blow, ABC's accountant, was more at fault for the extensive underreporting than was its president. Finally, it asserts that Doe's plea of guilty for attempting to file fraudulent tax returns "... should not be considered in this case a confession. It should be considered business judgment and knowledge of the requirement to really have to pay up." Tr. pp. 92-93.

The first part of ABC's defense appears to be that it did not file its returns with an intent to defraud because its president reasonably relied on ABC's accountant to properly prepare its monthly ROT returns. But there is no reasonable cause exception to a fraud penalty. 35 **ILCS** 735/3-8. Nor is this a responsible officer penalty case, where the evidence must show that Doe was a responsible officer who willfully failed to file returns, willfully failed to pay taxes owed, or who otherwise willfully attempted to defeat the collection of the tax. Here, the facts need not show that it was Doe who acted with an intent to defraud — the evidence need only show that ABC's returns were filed with an intent to defraud. 35 **ILCS** 735/3-6.

As to the substance of ABC's arguments, it does not dispute the significant deficiency disclosed by the Department's audit of its business. *See* Tr. pp. 24 (objection

by counsel for ABC to Department Ex. 3), 86 (during closing argument, ABC's counsel acknowledged its substantial understatement of tax). ABC significantly understated the correct amount of tax due on its monthly returns because it did not report most of the taxable gross receipts it collected from selling goods at retail during the audit period. Department Ex. 3; Tr. p. 18 (Lynch). The undisputed evidence shows that ABC reported that it received, on average, approximately \$ 3,284 from selling goods at retail for each month in the audit period. Department Ex. 3 ($91,941/28 \approx 3,283.60$). Doe, however, told Lynch that ABC took in from \$400 to \$700 dollars a day from selling goods at retail, and that ABC's business had remained relatively constant during the audit period. Tr. pp. 17-18 (Lynch). Since Doe knew that ABC took in from \$400 to \$700 dollars a day, she must have also known that after a period of 30 days, ABC would have realized from \$12,000 to \$21,000 ($400 \times 30 = 12,000$, $700 \times 30 = 21,000$) from selling goods at retail. Department Ex. 3. Given that its president knew that ABC took in from \$12,000 to \$21,000 each month in the audit period, how does it account for the fact that its president signed returns on which ABC reported that it received, on average, only \$3,284 a month from selling goods at retail? Doe attempted to explain it by testifying that she "... never knew what was on those things. I mean, I didn't know what they were about." Tr. p. 70 (Doe). That testimony is not credible.

Doe testified that she worked at the store every day and that the income she earned from the store's operations was her sole source of income. Tr. pp. 73-74, 81 (Doe). She said that she took readings from ABC's cash register every day. Tr. p. 76 (Doe). On occasion, she ran a cash register tape for the time while she worked at the store, and then another for the time when her husband worked at the store, and compared

who sold more. Tr. p. 76 (Doe). Doe was also the person who purchased goods for resale by ABC, who dealt with its suppliers, obtained its licenses, did its banking, etc. Tr. pp. 17-20 (Lynch), 80-84 (Doe). Doe had been ABC's president for approximately ten years, during which time it was able to purchase the building in which it conducted business. Tr. pp. 81-82, 84 (Doe). All of that evidence makes it clear that, if anyone was in a position to know what ABC's daily gross receipts were, it was Doe. Even if she truly did not know how ABC's tax liability was calculated, Doe signed returns each month on which consistent, gross and self-interested understatements of what the correct amount of ABC's taxable gross receipts were reported. Doe's testimony that she was wholly ignorant of what was reported on ABC's monthly ROT returns is inconsistent with the actions of a person who has personally and substantially presided over a continuing corporation for ten years.

Additionally, the reason why a corporate official is required to sign a corporation's monthly ROT returns — or any corporate tax return — is to make sure that someone with actual personal knowledge of the corporation's activities review the return and then attest, under penalty of perjury, that the information included on the return is true and correct. 86 Ill. Admin. Code §§ 130.525(a) ("Returns must be signed by the president, vice president, secretary or treasurer, or by the properly accredited agent whose power of attorney is on file with the Department, if the seller is a corporation."); 130.560 ("Each return or notice required to be filed under this Act shall contain or be verified by a written declaration that it is made under the penalties of perjury."); *see also* the forms directory on the Department's web site, <http://www.revenue.state.il.us/> (the signature line on Illinois' tax forms provides, "Under penalties of perjury, I state that I have examined

this return, and to the best of my knowledge, it is true, correct, and complete.”). Doe is and was ABC’s president, and she cannot defeat the imposition of a penalty merely by testifying that she did not know how her accountant calculated the correct amount of ABC’s tax, or that she did not read the returns she signed. Tr. p. 70 (Doe); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053 (“A taxpayer cannot overcome the DOR’s prima facie case merely by denying the accuracy of its assessments.”); Puleo, 117 Ill. App 3d at 268, 453 N.E.2d at 53 (fraud penalty upheld where evidence showed that person who signed and filed monthly returns knew that they understated the business’ actual taxable gross receipts).

Similarly, I find Doe’ testimony that she pled guilty to the criminal offense of attempt, but that she was not, in fact, guilty of that offense, unworthy of belief. Illinois criminal procedure requires a judge to make certain admonitions to a defendant personally, in open court, before it accepts a plea of guilty and determines the factual bases for such a plea. 725 **ILCS** 5/115-2(a); Illinois Supreme Court Rule § 402(a)-(c); *see also e.g., Spircoff v. Stranski*, 301 Ill. App. 3d 10, 15-16, 703 N.E.2d 431, 435 (1st Dist. 1998) (quoting from transcript of court’s admonitions to defendant). Invariably, when undertaking those responsibilities, the court seeks to satisfy itself that the defendant is pleading guilty because he or she is, in fact, guilty of the offense. Either Doe was telling the truth when she pled guilty in open court to the offense of attempt, or she was not telling the truth when she testified, in this case, that she was not guilty. If, in fact, she was lying when she pleaded guilty, I see no reason why she should not have to live with the effect of that prior conduct in this matter. More importantly, Doe’ conscience awareness that ABC’s actual taxable gross receipts were much greater than were reported

on the corporate returns she signed during the audit period makes it much more certain that she pled guilty because she did, in fact, intend to file fraudulent tax returns.

Attempt, moreover, is a specific intent crime. People v. Gilman, 113 Ill. App. 3d 73, 76, 446 N.E.2d 595, 597 (4th Dist. 1983) (“To sustain a charge of attempt it must be shown that a defendant formed the specific intent to commit a crime”). The specific crime Doe pleaded guilty of attempting to commit was the offense of filing fraudulent tax returns. Department Ex. 4, p. 2. The Illinois General Assembly defined the term “intent” to mean that a person acts with a “... conscious objective or purpose ... to accomplish that result or engage in that conduct.” 735 ILCS 5/4-4 (definition of “intent”); *see also* Gilman, 113 Ill. App. 3d at 76, 446 N.E.2d at 597 (“The committee comments to section 4-3 [now § 4-4 of the Criminal Code] reveal that the use of the word ‘intent’ in the Code is limited to conscious objective or purpose to accomplish a described result.”). In order to form intent, one must first be aware of the surrounding circumstances and then intend to commit a specific unlawful act. Gilman, 113 Ill. App. 3d at 77, 446 N.E.2d at 597. Since Doe pled guilty to the specific intent crime of attempting to commit the offense of filing fraudulent tax returns, and since intent requires an awareness of the surrounding circumstances, her testimony that she did not know what was on the monthly returns she signed during the audit period is simply not believable.

The Department’s introduction of proof of Doe’s sentence in that related criminal matter (Department Ex. 4, p. 2) and Doe’s own acknowledgment of her plea of guilty to that misdemeanor offense (Tr. p. 73 (Doe)) are acts that are contrary to the position ABC took at hearing, i.e., that Doe did not intend to file fraudulent returns. Tr. p. 85 (closing argument). Thus, that evidence constitutes an admission that ABC’s returns were filed

with an intent to defraud. Spircoff v. Stranski, 301 Ill. App. 3d 10, 15-16, 703 N.E.2d 431, 435 (1st Dist. 1998) (noting modern trend to give proof of a party's conviction a conclusive effect, where the criminal and subsequent matters are closely correlated); In re Cook County Treasurer, 166 Ill. App. 3d 373, 379, 519 N.E.2d 1010, 1014 (1st Dist. 1988) *aff'd* 131 Ill. 2d 541 (1989) (contradictory statements of a party constitute substantive evidence against the party of facts stated); Quincy Trading Post, Inc. v. Department of Revenue, 12 Ill. App. 3d 725, 731-32, 298 N.E.2d 789, 794 (4th Dist. 1979) (vice-president's out-of court statements to auditor regarding matters within scope of duties were admissible against corporation); Cleary & Graham, Handbook of Illinois Evidence (7th ed. 2000) §§ 802.5, 802.8. In this case, therefore, proof of ABC's intent to defraud is not based on mere circumstantial evidence — which circumstantial evidence, to be sure, amply demonstrates the consistency, duration and extent of ABC's understatement of its monthly taxable gross receipts. Department Ex. 3; Tr. p. 18 (Lynch, relating Doe' statement to him regarding ABC's daily taxable gross receipts); *see also* Puleo, 117 Ill. App 3d at 268, 453 N.E.2d at 53-54. It is also demonstrated by substantive evidence that the corporate officer who signed and filed ABC's monthly ROT returns admitted that she intended to file fraudulent corporate returns. Department Ex. 4, p. 2.

Conclusion:

There is no dispute that Doe had actual personal knowledge that ABC made at least three times more each month from selling goods at retail than the returns she signed reported that it made, and that she pled guilty to attempting to file fraudulent tax returns regarding the same period. Contrary to taxpayer's arguments, the evidence introduced at

hearing is sufficient to show, by clear and convincing evidence, that ABC filed its tax returns during the audit period with an intent to defraud. 35 **ILCS** 735/3-6. I recommend, therefore, that the Director finalize NTL no. 00-0000000000000000 as issued, with interest to accrue pursuant to statute.

5/20/02
Date

Administrative Law Judge